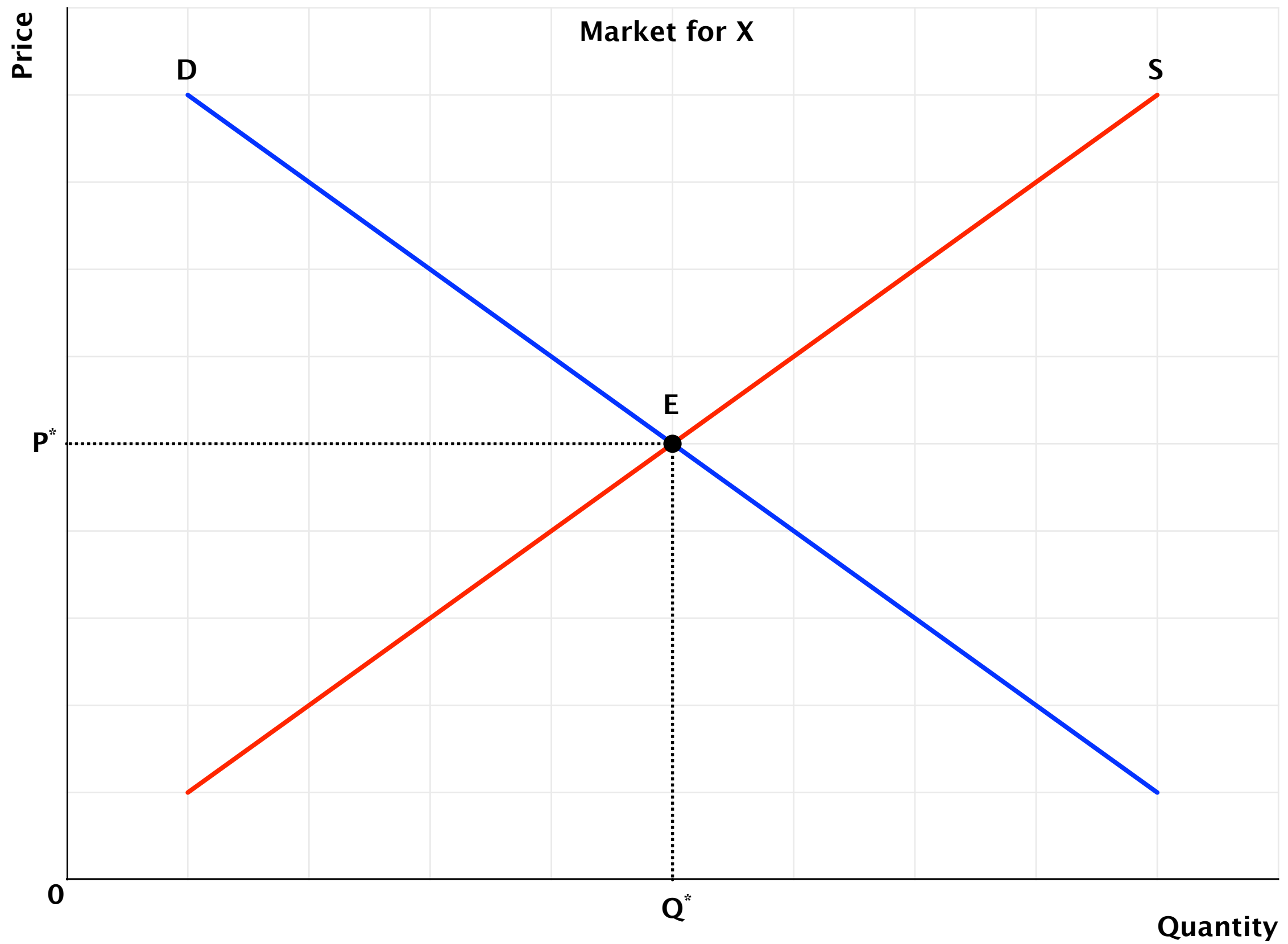


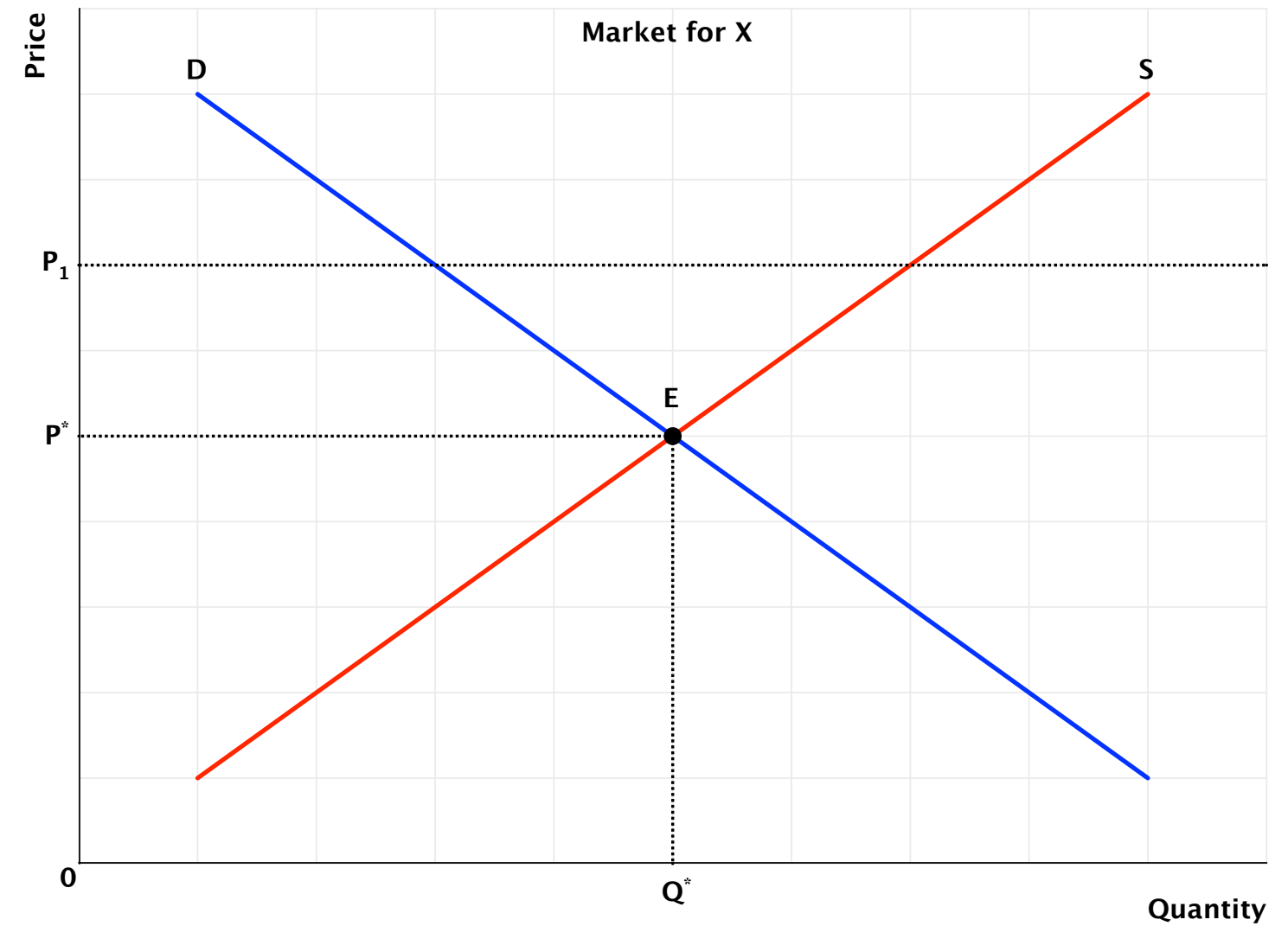
Supply & Demand

Interaction and Application

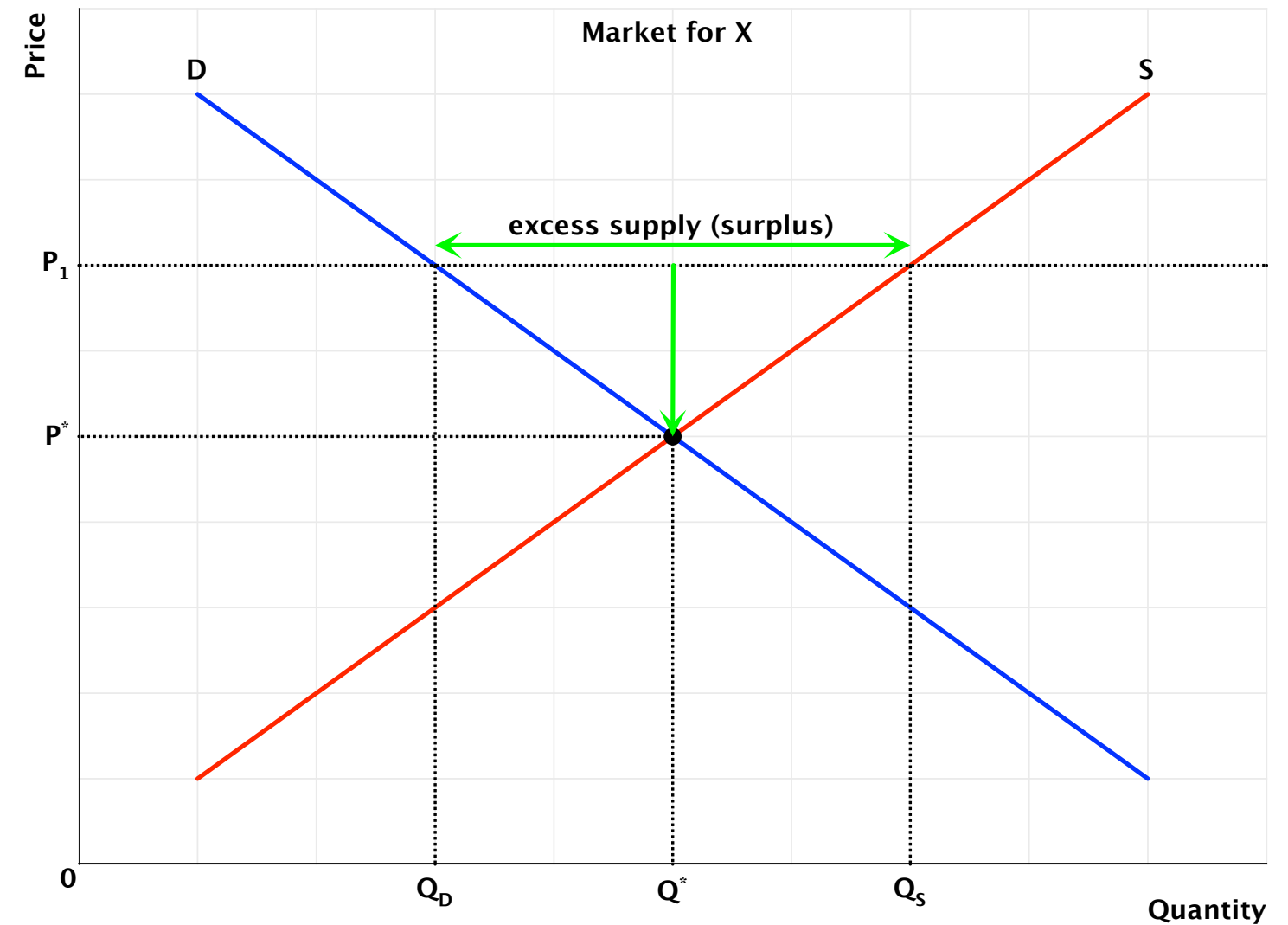


- Whenever price, demand, and supply cross at the same point, the market is at equilibrium – the quantity demanded equals quantity supplied.
- If one of these things changes, the market will adjust to reach equilibrium if it is allowed to operate freely – the price will increase/decrease as needed.

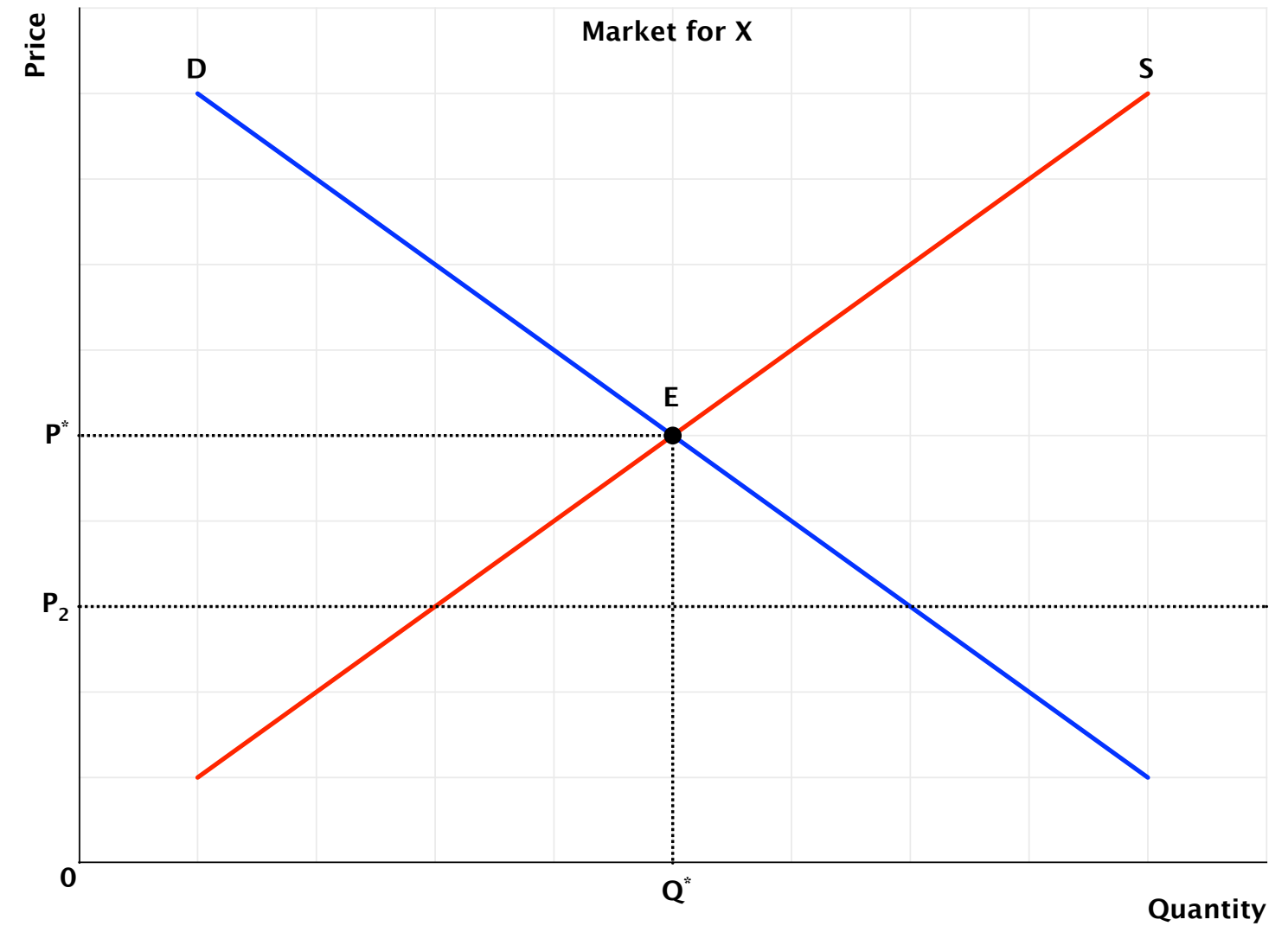
- What happens if producers try to raise the price?



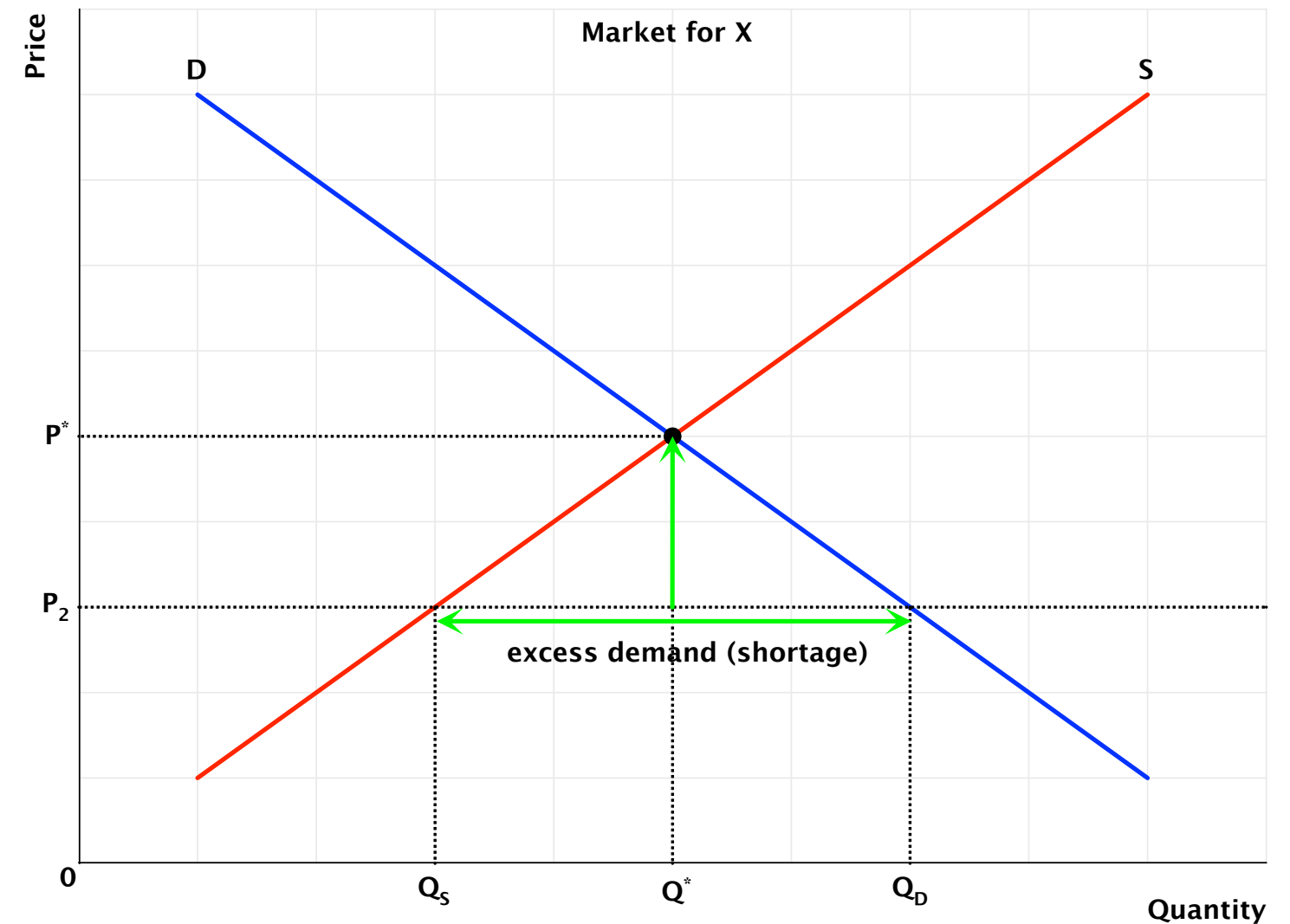
- The quantity supplied increases and the quantity demanded decreases, creating excess supply, or a surplus.
- In order to eliminate the surplus, producers will lower the price until Q_S equals Q_D – which occurs at equilibrium.



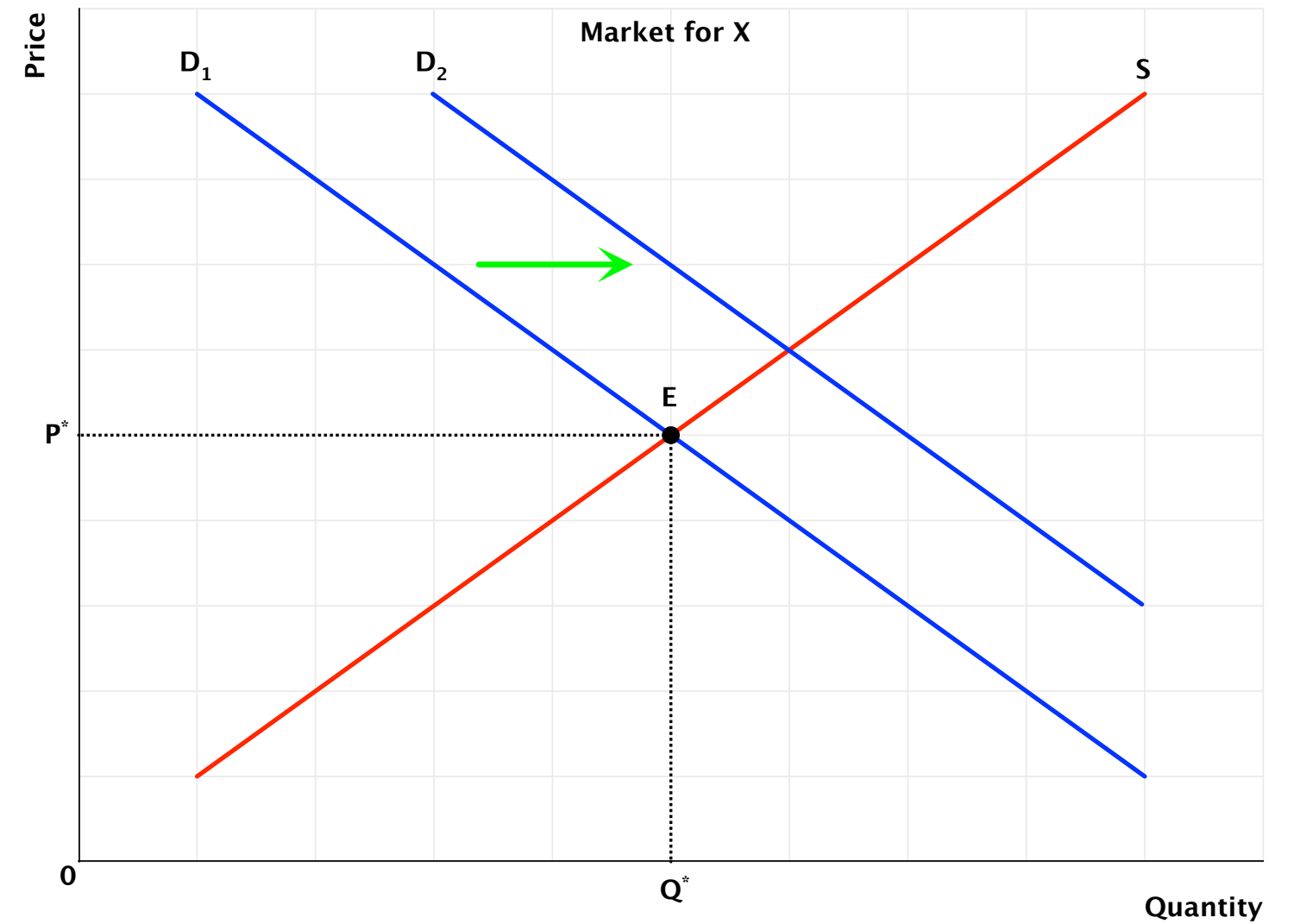
- What happens if producers try to lower the price?



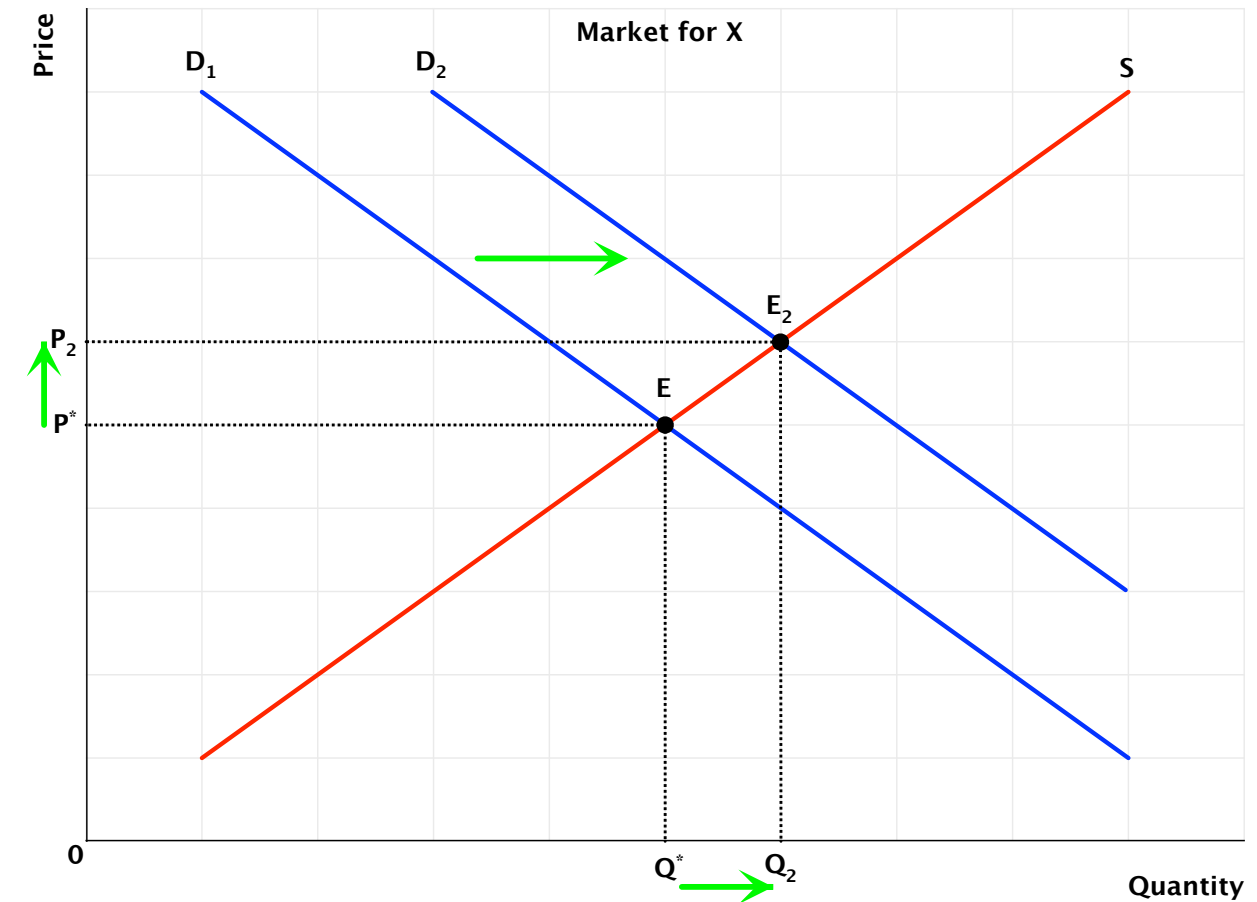
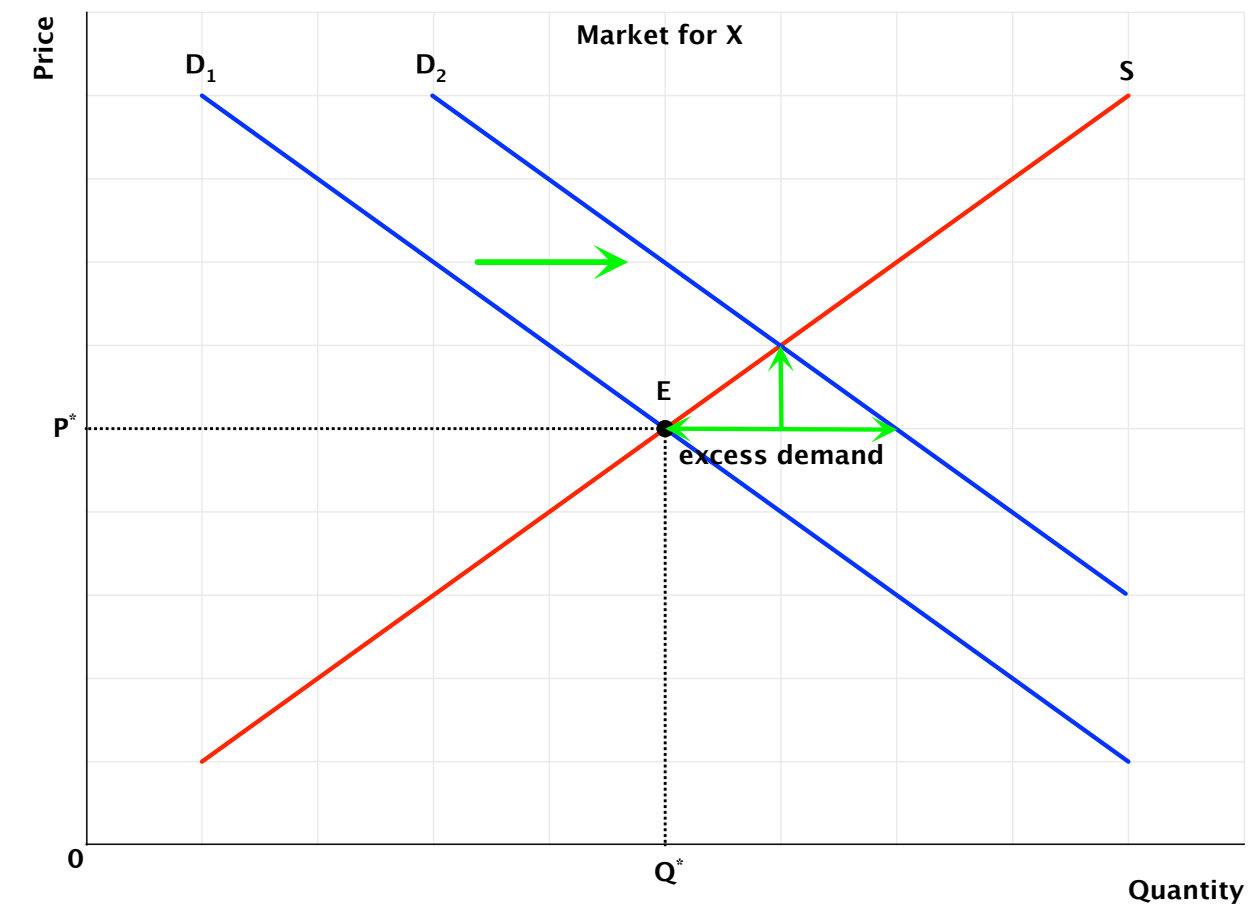
- The quantity supplied decreases and the quantity demanded increases, creating excess demand, or a shortage.
- In order to eliminate the shortage, producers will raise the price until Q_S equals Q_D – which occurs at equilibrium.



- What happens if demand increases?



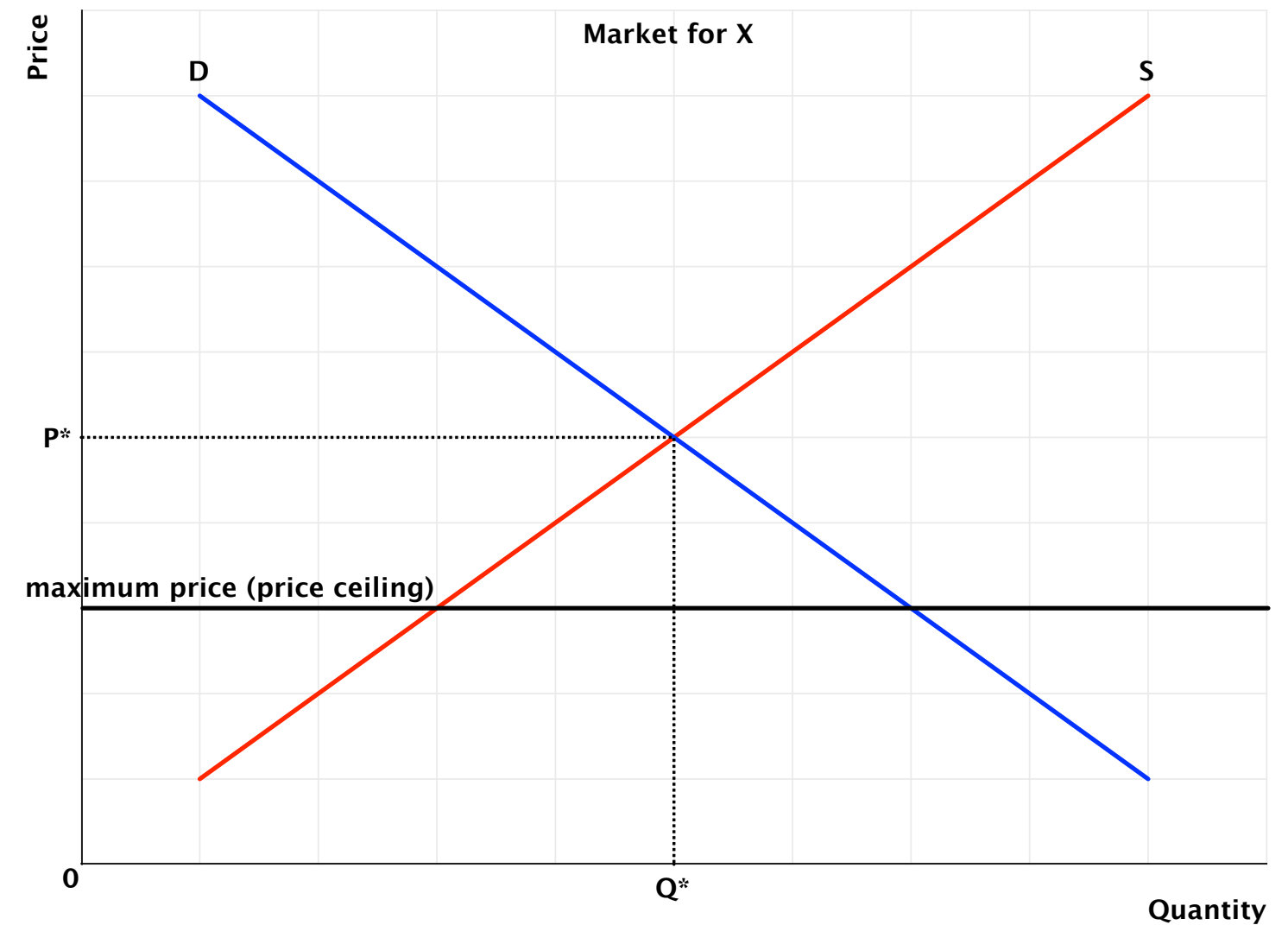
- Initially, there is excess demand, but the price will rise until Q_D equals Q_S .



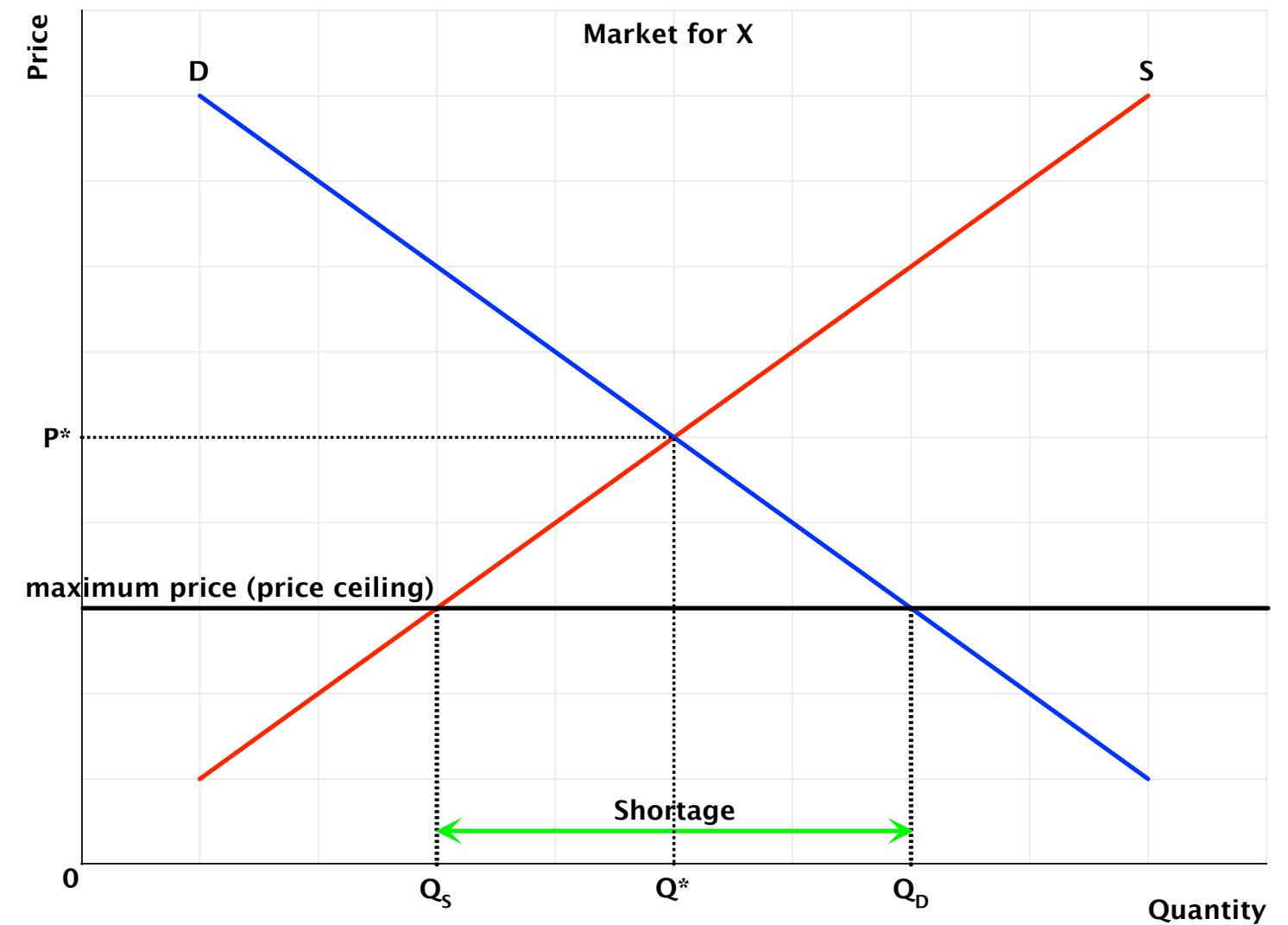
- The same sort of adjustment occurs when demand decreases, supply increase, and supply decreases.

- Sometimes, governments do not like the market equilibrium and will try to intervene in the market to achieve a different outcome.
 - maximum prices (price ceilings)
 - minimum prices (price floors)

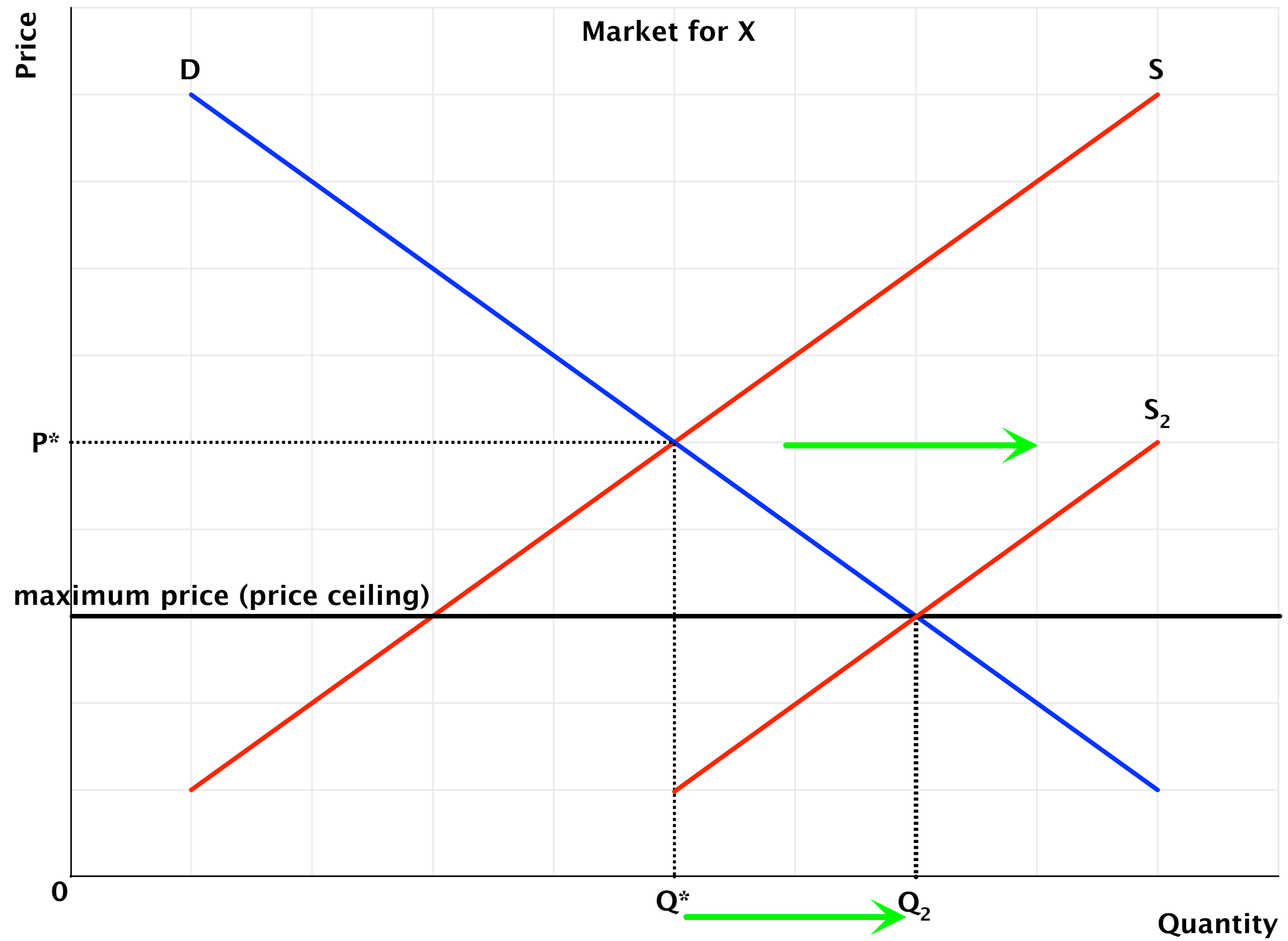
- Suppose the government wants to make sure that rice is affordable for more people, so it decides to implement a maximum price (price ceiling) for rice.



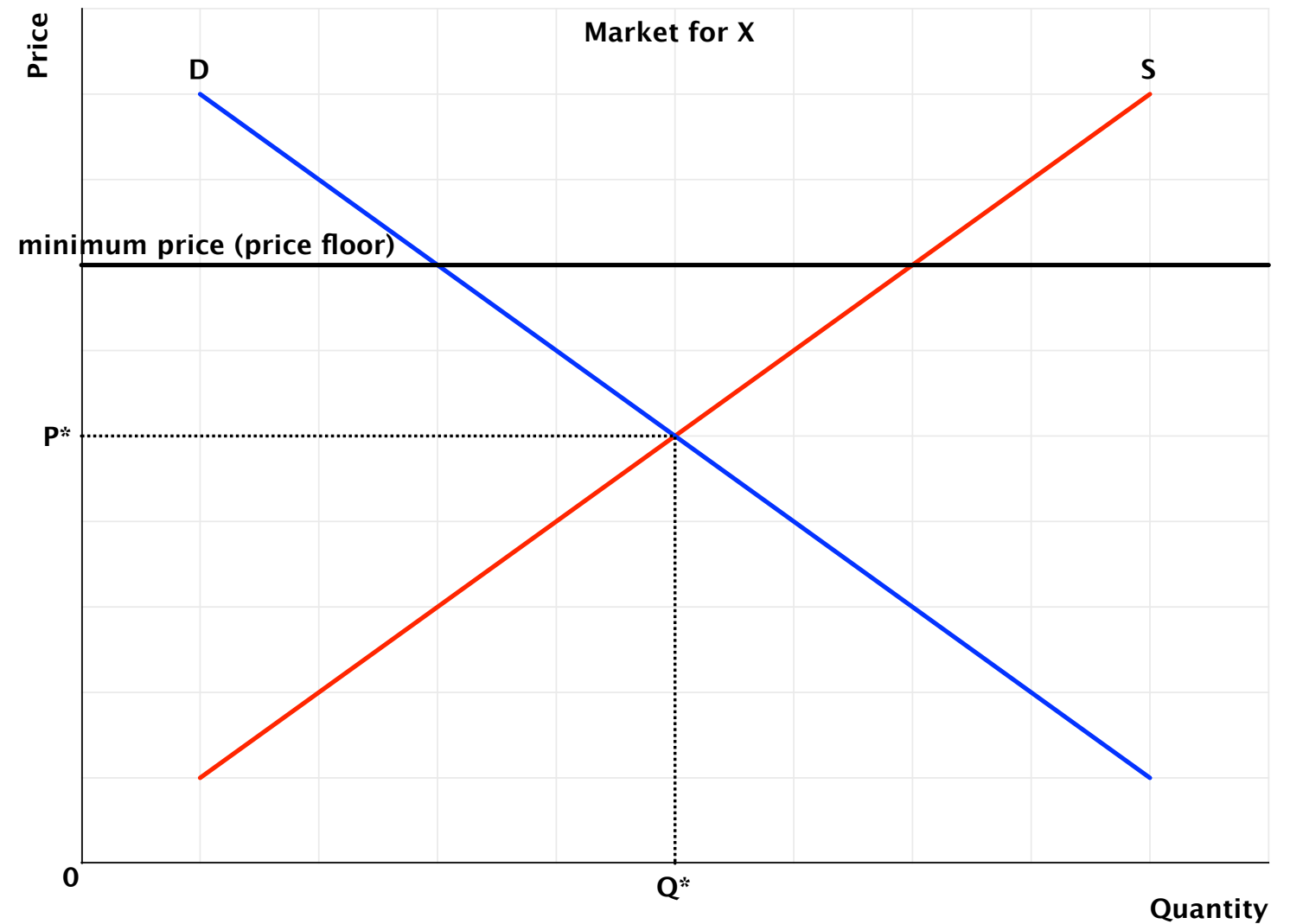
- The maximum price (price ceiling) creates excess demand (shortage). Fewer people will be eating rice than before!



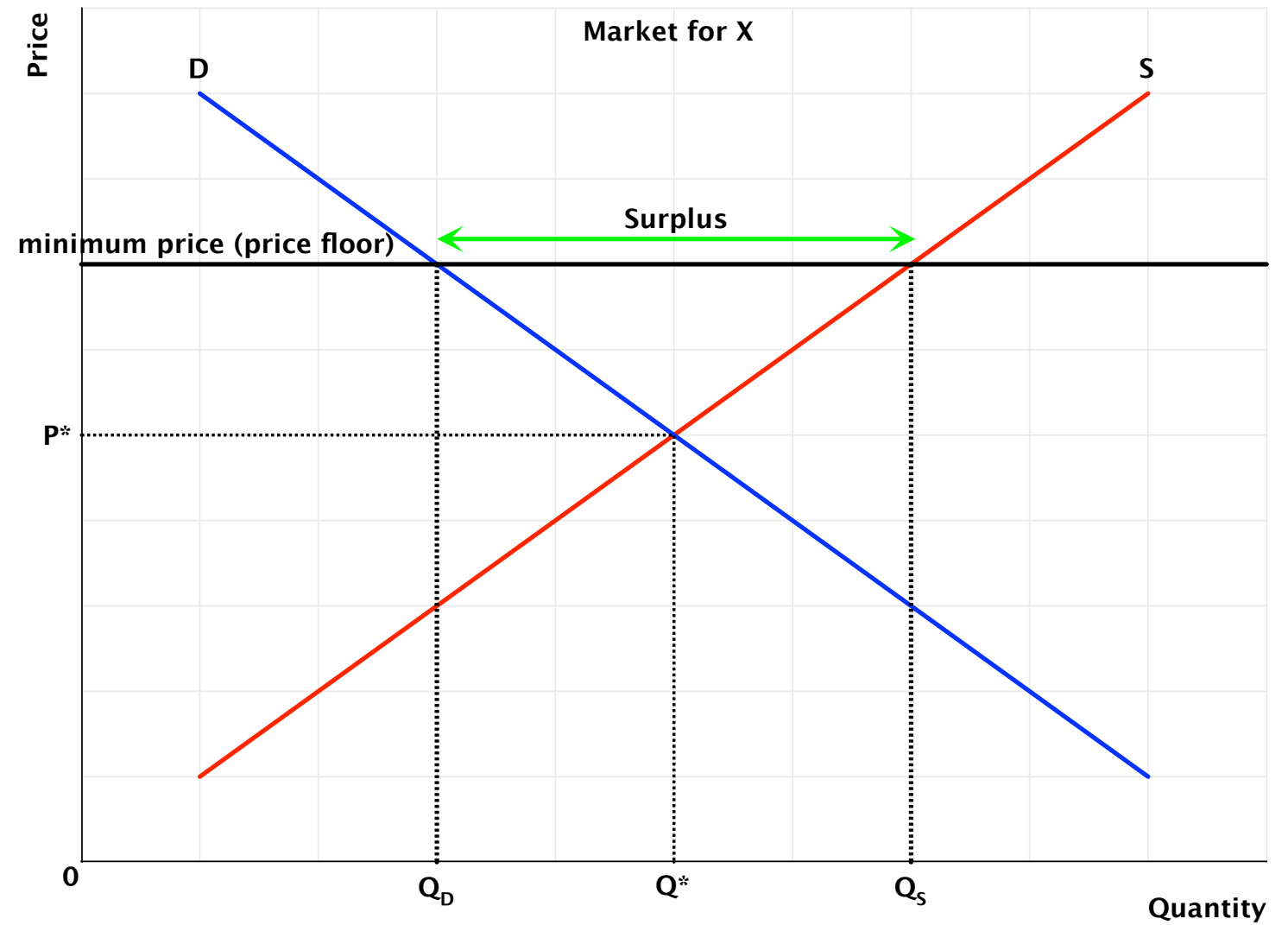
- To eliminate the shortage it created (and keep the maximum price), the government can:
 - decrease demand (which would decrease consumption of rice – not really what it wants to do)
 - increase supply by offering subsidies to rice producers, producing rice itself, and/or releasing some extra rice it had purchased before.



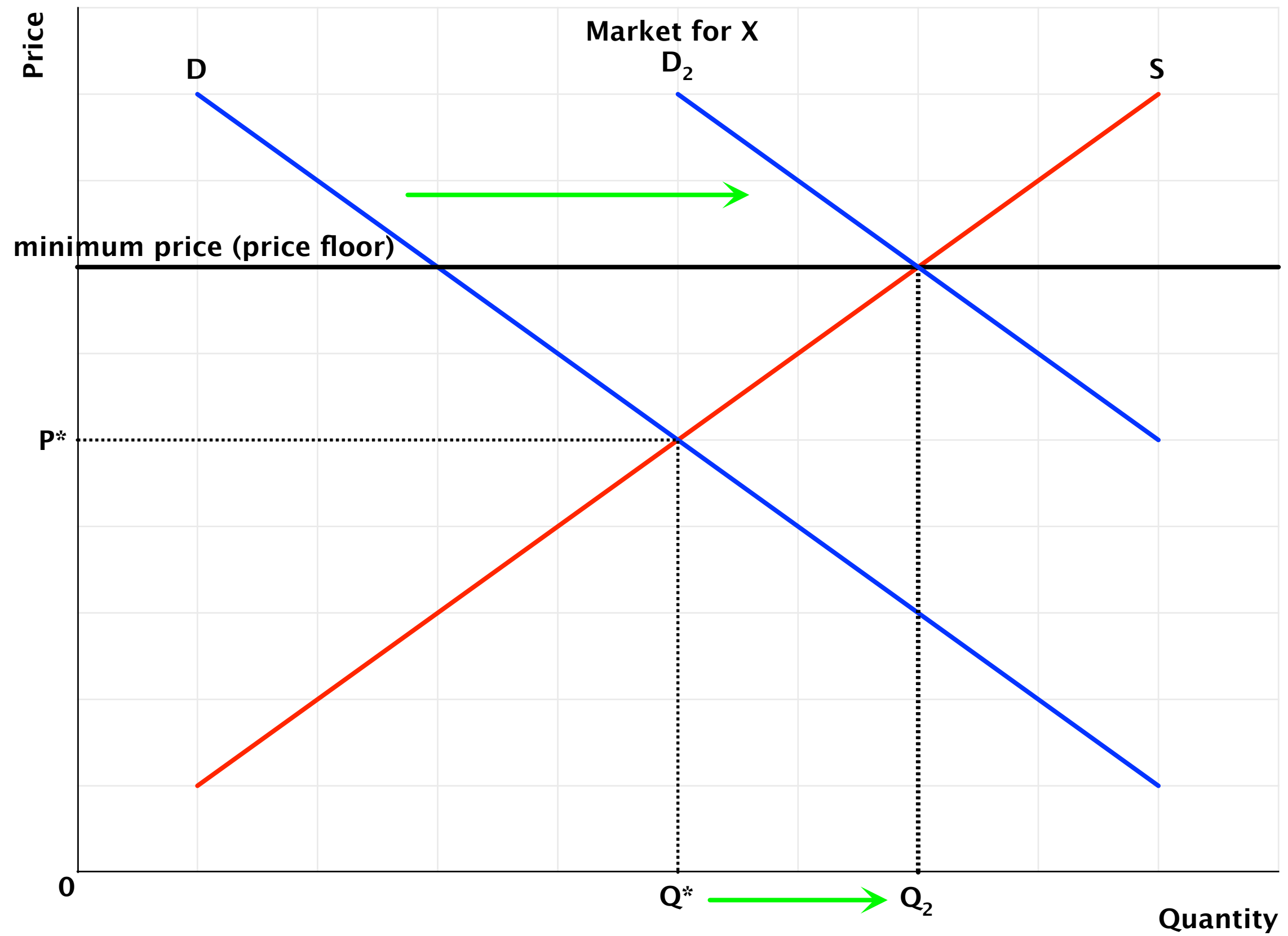
- Suppose the government wants to raise incomes for the makers of dragon repellant, so it decides to implement a minimum price (price floor) for dragon repellant.



- The minimum price (price floor) creates excess supply (surplus), and producers will want to sell for a lower price.



- To eliminate the surplus it created (and keep the minimum price), the government can:
 - impose a quota, which restricts supply (but then only some producers will benefit from the minimum price)
 - increase demand by buying the surplus products, by advertising the product, and/or restricting supply of imported products (which are substitutes for the domestically produced products)



- Whenever the government needs to spend money to “fix” a market, there is an opportunity cost!